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No. 61

In the Supreme Court of the United States

OCTOBER TERM, 1929

E. FRANKLIN BREWSTER, PETITIONER

v.

BERT P. GAGE, COLLECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT

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OPINIONS BELOW

The opinion of the United States District Court for the Western District of New York (R. 16–18) is reported in 25 F. (2d) 915. The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. 25–30) is reported in 30 F. (2d) 604.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Second Circuit was entered February 11, 1929. (R. 30.) Petition for certiorari was filed

April 4, 1929. Certiorari was granted May 13, 1929. (R. 33; 279 U. S. 831.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Under Section 202 (a) (2) of the Revenue Act of 1918 and Section 202 (a) (3) of the Revenue Act of 1921, where petitioner, as one of five residuary legatees, received certain securities from his father's estate, which he subsequently sold, is the basis of ascertaining the taxable gain from the sale, the value of the securities at the time of decedent's death, or their value on the date of the surrogate's order of distribution?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof * * *.

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

> SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from

a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(3) In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition * * *.

Revenue Act of 1918, 40 Stat. 1065:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * but

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

* * * * *

Section 213 of the Revenue Act of 1921, 42 Stat. 237, is identical with Section 213 of the Revenue Act of 1918.

Regulations 33, Revised (promulgated January 2, 1918, under the Revenue Acts of 1916 and 1917), paragraph 44, p. 11:

> *Value of property acquired by inheritance.*—The appraised value at the time of the death of a testator is the basis for determining gain or profit upon sale subsequent to the death after March 1, 1913.

Regulations 37, relating to the Estate Tax, under the Revenue Act of 1918, Article 15:

> *Rules for the valuation of property.*—
> * * *
>
> (2) *Stocks and bonds.*—The value of stocks and bonds listed upon a stock exchange should be obtained by taking the mean between the highest and the lowest sale price upon the day of death, provided the sales were made in the regular course of business, and not for the special purpose of establishing value. * * *.

Regulations 45 (approved April 17, 1919, under the Revenue Act of 1918), Article 1562:

> *Sale of property acquired by gift or bequest.*—In the case of property acquired by gift, bequest, devise, or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at

the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73.

Regulations 62 (approved February 15, 1922, under the Revenue Act of 1921), Article 1563:

Sale of property acquired by gift on or before December 31, 1920, or by bequest, devise, or inheritance.—In computing the gain or loss from the sale or other disposition of property acquired by gift on or before December 31, 1920, or by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of acquisition. * * * In the case of property acquired by bequest, devise, or inheritance, its value as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes shall be deemed to be its fair market value when acquired.

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Regulations 65 (approved October 6, 1924, under the Revenue Act of 1924), Article 1594, and Regulations 69 (approved August 28, 1926, under the Revenue Act of 1926), Article 1594, are substantially the same as Regulations 45, Article 1562, and Regulations 62, Article 1563, *supra*.

STATEMENT

Petitioner's father died May 20, 1918 (R. 10), and the petitioner was one of the residuary legatees of his father's will. In the Surrogate's Court, County of Monroe, City of Rochester, New York, there was entered April 19, 1920, a decree or order of final distribution (R. 5–16) whereby the executors of the will of the father were directed to distribute certain securities to the petitioner. (R. 11–12.) Some of these securities were sold by petitioner during the years 1920, 1921, and 1922 (R. 5), and in the table printed below are set forth (1) the years in which the respective sales were made; (2) the number of shares sold (all of the securities sold being common or preferred stocks), and the names of the issuing corporations; (3) the prices realized by the sales; (4) the values of the sold stocks at date of the father's death (as appraised for Federal estate tax purposes); and (5) their values on April 19, 1920, the date of the order of distribution.

TABLE

(1) Year sold	(2) Securities	(3) Sale price	(4) Value at father's death	(5) Value at Apr. 19, 1920
1920	22 shs. Eastman Kodak	$11,550.00	$9,350.00	$12,100.00
1920	25 shs. Lincoln Bank	6,250.00	5,500.00	6,875.00
1920	15 shs. American Chicle, pfd	944.40	945.00	1,080.00
1921	66 shs. Childs Co., com	6,257.46	4,290.00	5,940.00
1922	22 shs. Bankers Trust Co	8,024.72	5,398.58	8,514.00
1922	60 shs. Gen'l Cigar Co. (United Cigar Stores), com	4,631.10	2,700.00	4,140.00
		37,657.68	28,183.58	38,649.00

This table differs from the one found on page 5 of the Record in these respects, viz: It omits the value of the stocks as of June 28, 1920, the date when they were received by petitioner, since those values are not here material under the contentions of the parties. It adds a column giving the value of the stocks on April 19, 1920 (R. 11–12), the date of the decree or order of distribution. See stipulation on page 22 of the Record.

The petitioner duly executed and filed his individual income tax returns for the calendar years 1920, 1921, and 1922, and paid the amount of taxes respectively disclosed thereon. Subsequently, upon an examination and audit of the returns, the Commissioner of Internal Revenue determined that additional income taxes were due from the petitioner for such three years, as follows: $1,799.68 for the year 1920, $94.94 for the year 1921, and $453.59 for the year 1922, or a total of $2,348.21. These several amounts were duly assessed, and paid by petitioner under protest, together with interest

amounting to $53.69. Petitioner then filed with the respondent Collector claims for refund of the taxes and interest so paid, each of which claims the Commissioner of Internal Revenue rejected in its entirety. (R. 4.) Thereafter petitioner sued the Collector in the United States District Court for the Western District of New York to recover the taxes and interest thus paid.

In computing the profit or gain arising from the sale of the stock, the Commissioner of Internal Revenue subtracted from the selling prices the values of such stocks on date of the death of petitioner's father. (R. 5.) Whether or not the Commissioner was correct in using this basis rather than the value at the time of distribution was the issue raised by petitioner in his suit to recover the additional taxes paid. (R. 3.) The District Court (trial by a jury being waived in writing and the case submitted upon stipulated facts (R. 22)) held that the date of the order of distribution, and not that of the father's death, controlled and gave judgment for the petitioner. (R. 16–19.) That judgment was reversed by the Circuit Court of Appeals for the Second Circuit, which held that the date of the father's death governed. (R. 25–30.) The petitioner thereafter applied to this Court for a writ of certiorari, which was granted. (R. 33.)

SUMMARY OF ARGUMENT

The sales made in 1920 are governed solely by the Treasury regulations which specifically provide

that the basic date for determining the gain or loss on the sale of property acquired by bequest is the date of the testator's death. These regulations provide rules of general application to devises of real property and bequests of personalty. Since a residuary legatee acquires a vested interest at the testator's death in all the assets of the estate not otherwise disposed of by will, the regulations correctly brought residuary legatees under the general rule. The regulations find support in reason and authority, are calculated to carry out the congressional purpose, are in harmony with the statute, and hence have the force and effect of law.

In exempting from the beneficiary's income the value of property acquired by bequest, Congress intended to sacrifice only the increase in the value of the property which was unrealized at death. This is shown by the provision of Section 219 of the Revenue Act of 1918 which creates out of the estate a new taxable entity which is accountable for all realized gains accruing since the testator's death. In certain cases that section makes the beneficiary accountable for his portion of the income whether distributed or not. Accordingly, the regulations fixing the value at the time of death as the basis for determining gain or loss gave full effect to the exemption in Section 213.

The sales made in 1921 and 1922 are controlled by the Revenue Act of 1921, in which Congress included as the specific basis for determining the gain or loss upon the sale of property acquired by

bequest, the value of the property at the time of such acquisition. In view of the practice under the earlier Acts, the effect of the 1921 Act was to carry into the law the rule of the Treasury Department that the basic date was that of the testator's death. The contemporaneous construction placed upon the Act by the Treasury regulations and the subsequent legislative history of the provision remove any doubt that this was the purpose of the 1921 Act. The change in the 1928 Act was not designed to have any retroactive effect but was due to a change of congressional purpose.

ARGUMENT

I

THE REVENUE ACT OF 1918 SPECIFIES NO BASIS FOR DETERMINING GAIN OR LOSS ON THE SALE OF BEQUEATHED PROPERTY. THE TREASURY REGULATIONS FIX THE VALUE AT THE DATE OF DEATH AS THE BASIS. THE REGULATIONS HAVE THE FORCE AND EFFECT OF LAW AND ARE DECISIVE.

The question involved in this case is the determination of the proper basic date for computing the gain derived from the sale of certain stock received by petitioner as a bequest. The securities were received by petitioner as one of five residuary legatees under the will of his father who died May 20, 1918. The taxes sought to be recovered were assessed and collected upon the theory that the date of death was the basic date for determining gain upon the sale. Petitioner contends that the value

of the securities on the date of the Surrogate's order of distribution, April 19, 1920, is the proper basis. Since the stock increased in value between those dates it is evident that if the earlier date is the basis, the gain realized by petitioner when the stock was sold was greater than it would be if the later date should be adopted as the basis.

Sales of this stock were made by petitioner in 1920, 1921, and 1922. Accordingly, the 1920 sales are governed by the provisions of the Revenue Act of 1918, while the later sales are governed by the Revenue Act of 1921. The only basis specifically mentioned in the 1918 Act for property acquired after March 1, 1913, is cost. There was no specific provision in the Act of 1918 which fixed the basis for determining gain or loss on the sale of property acquired by bequest, devise, or inheritance. Neither was there any such provision in the earlier Acts. Transactions arising under those Acts are therefore governed by the Treasury regulations. The earliest regulation on the subject is found in Regulations 33 (Revised), governing the collection of the income tax imposed by the Revenue Act of 1916 as amended by the Revenue Act of 1917. Paragraph 44 of these regulations provides as follows:

> *Value of property acquired by inheritance.*—The appraised value at the time of the death of a testator is the basis for determining gain or profit upon sale subsequent to the death after March 1, 1913.

Regulations 45, promulgated under the Revenue Act of 1918, provide as follows:

> ART. 1562. *Sale of property acquired by gift or bequest.*—In the case of property acquired by gift, bequest, devise, or descent the basis for computing gain or loss on a sale is the fair market price or value of the property at the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise, or descent since February 28, 1913, its value as appraised for the purpose of the federal estate tax, or in the case of estates not subject to that tax its value as appraised in the State court for the purpose of State inheritance taxes, should be deemed to be its fair market value when acquired. See section 213 (b) (3) of the statute and article 73.

This article does not specify the date of death as the basic date for determining gain or loss on the sale of bequeathed property but provides that the basis shall be the value of such property as appraised for the purpose of the Federal estate tax or, in some cases, State estate taxes. But this is tantamount to fixing the value at the date of death as the basis, because Section 402 of the Revenue Act of 1918 (40 Stat. 1097), dealing with the estate tax, provides:

> That the value of the gross estate of the decedent shall be determined by including the value *at the time of his death* of all prop-

erty, real or personal, tangible or intangible, wherever situated. (Italics ours.)

Regulations 37, Article 15, interpreting Section 402 of the Act, provide that the value of stocks and bonds listed upon a stock exchange should be obtained by taking the mean between the highest and lowest sale price *upon the day of death.* Accordingly, it is clear that the regulations under the 1918 Act, like the regulations under the 1916 and 1917 Acts, require that the computation of gain or loss on the sale of property acquired by bequest, devise, descent, or inheritance, shall be made on the basis of the value of the property at the decedent's death. For a Departmental ruling under facts similar to those of the case at bar see O. D. 667 published in C. B. 3, page 52 (1920).

The sales of stock made in 1920 by the petitioner are governed by these regulations, which we submit are in harmony with the statute and authoritative aids in disposing of the question presented. It is settled that regulations made by a department of government, addressed to and reasonably adapted to the enforcement of an Act of Congress, the determination of which is confided to such department have the force and effect of law, if not in conflict with express statutory provisions. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 349; *Bellefield* v. *Heiner* (C. C. A. 3d), 25 F. (2d) 560.

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Congress has adopted a broad definition of gross income with the purpose of exercising its power to tax income to the fullest extent. See *Irwin* v. *Gavit*, 268 U. S. 161, 166. By Section 219 of the Revenue Act of 1918 there was specifically imposed a tax upon the income received by estates of deceased persons during the period of administration or settlement of the estate. Accordingly, if the estate had sold the stock involved in this case, the income realized by sale would have been taxable thereunder. The estate did not sell the stock, but turned it over to the beneficiary together with the increment of increased value which had not yet been realized. Since it seemed to be the intention of Congress to reach that increment when it was realized by sale of the securities, the Treasury Department, charged with the duty of promulgating regulations reasonably adapted to the enforcement of the Act, ruled that the time of the testator's death should be the basic date for the computation of gain or loss on the sale of property acquired by bequest. Any other rule would have created a hiatus in the continuity of the tax and resulted in a part of the increment of increased value of the property escaping the tax.

This rule fixing the value at the date of the testator's death as the basis for computing gain or loss not only prevents a hiatus with respect to income derived from property received by a beneficiary and subsequently sold, but it likewise gives effect

to losses in value occurring while the estate is under administration. In truth, the stock represented only a single investment of capital—that made by the testator—and when through sale the increase was separated therefrom it became income from that investment in the hands of the recipient subject to taxation according to the very words of the Sixteenth Amendment. When Congress specifically required the recipient of the entire increase in a gift to account for all of the increase over the donor's investment as income, this Court held that the provision of the statute was entirely appropriate for enforcing a general scheme of lawful taxation and that Congress acted neither unreasonably nor arbitrarily in enacting such statute. *Taft* v. *Bowers,* 278 U. S. 470.

So, in this case, we submit that the rule of the Treasury Department, holding the beneficiary accountable for the part of the increase which had accrued since the testator's death, was not only appropriate, but was essential in order to effectuate the evident purpose of Congress to tax all increase in property left by a decedent when the increase was realized by sale.

Not only do the regulations find support in their appropriateness to effectuate the Congressional purpose, but they are supported both by law and by reason when the realities of ownership of bequeathed properties are considered.

The regulations apply with equal force to property of every description, both real and personal.

We assume there is no objection to the rule of the Treasury as it affects real property acquired by devise or descent, since it has long been settled with respect to inheritances of real property that the interest of the heir or devisee is acquired upon the death of the deceased. Petitioner's objection to the rule as applied to personalty rests upon the proposition that title to it passes on death to the executor or administrator, and not to the legatee or distributee, who acquires no right of possession until a distribution is provided for.

In adopting regulations for the enforcement of the Revenue Acts we think that the Treasury Department is not bound by the strict rules relating to the devolution of title. In *Seattle* v. *Kelleher,* 195 U. S. 351, 359, this Court said, "The principles of taxation are not those of contract," and held that such principles could not prevent the taxing authorities from levying a special assessment for a public work already done. Moreover, taxation is a practical matter. This Court has held that Congress may tax as a corporation an association which, although unincorporated, transacts its business as if it were incorporated. *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110. When applying a Federal tax statute the Federal courts are free to determine rules of property independently of the local rule. *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503; *Weiss* v. *Weiner,* 279 U. S. 333, 337. In *United States* v. *Robbins,* 269 U. S. 315, this Court said that, even if it were assumed that a

wife has an interest in community income, it does not follow that Congress cannot tax the husband for the whole. Accordingly, we think that as a practical matter it was appropriate to charge the beneficiaries of personal property with an interest in the bequest from the time of the testator's death. Moreover, the law recognizes such an interest.

While it is true that the executor or administrator holds legal title to the personal property comprising the estate during the period of administration, it is equally true that the legatee who receives assets on distribution has been the real owner thereof from the time the assets came into the estate. If he takes a specific bequest, the property has been identified with him since the death of the testator and it is not subject to sale by the personal representative of the deceased except when all other personalty fails to yield sufficient proceeds to meet demands upon the estate. If the property changes in value during the administration of the estate, it affects the legatee alone. Even if he is a residuary legatee, such as the petitioner, he acquired a vested interest at the testator's death in all the assets of the estate not otherwise disposed of by the will. Schouler on Wills, Executors and Administrators (6th Ed.), Vols. 2, 4, Secs. 1299, 3062, 3148; Roper on Legacies, Vol. 1, p. 552; Jarman on Wills (6th Ed.), Vol. 1, p. 822. Such is the law in New York and generally. See *Matter of Lansing*, 182 N. Y. 238; *Matter of Russell*, 168 N. Y. 169;

Matter of Seaman, 147 N. Y. 69; *Vail* v. *Vail,* 49 Conn. 52; *Cook* v. *McDowell,* 52 N. J. Eq. 351.

It is well settled that the interest of a distributee of a decedent's estate attaches upon the date of the decedent's death. In *Hooper* v. *Bradford,* 178 Mass. 95, the question was whether, for the purposes of the Massachusetts collateral inheritance tax, stock left by the testator was to be valued as of the date of the testator's death or as of some later time. The stock had appreciated in value between the date of death and the date of distribution. In holding that the legacy tax was to be assessed on the value of the property as of the time of the testator's death, it was said (p. 97):

> The time when the property passes under a deed is not later than the death of the grantor. The same is true in the case of a will. It is true that in the latter instance the interest of a legatee is subject to an account, but still it is an interest in the fund as it is, analogous to that of a *cestui que trust,* and vests at the death of the testator.

To the same effect is *Mechanics' Savings Bank* v. *Waite,* 150 Mass. 234, and *Kingsbury* v. *Chapin,* 196 Mass. 533. The rule is the same in the case of intestacy. In *Perryman* v. *Greer,* 39 Ala. 133, the court said (p. 136):

> The right of a distributee attaches upon the death of the intestate. The interest then accrues, and the subsequent division serves to ascertain and define, convert into a legal

> right, and reduce to possession, an equity which existed before in the form of a *chose in action,* cognizable in chancery. Therefore, the property which the distributee of an estate receives under the statute of distribution, does not accrue to the distributee by virtue of the division or reduction to possession, but in consequence of a right springing up upon the death of the intestate.

The interests which vest in the legatees are equitable in their nature but they constitute the real and substantial ownership. To be sure, the rights of the legatees as to any specific assets may be divested if in the administration of the estate it becomes necessary that assets be sold to provide funds for payment of claims against the estate, but this possibility does not affect the question here. We are concerned with specific properties turned over to residuary legatees at distribution, and as to such there has been no divestiture. Even the title of a devisee to real property, which vests on the death of the testator, may be divested and the property sold to pay debts, if the personal property is insufficient. *Covell* v. *Weston,* 20 Johns. 414, 419. See Schouler on Wills, Executors and Administrators, 6th ed., Vol. 3, Sec. 1986; 23 Corpus Juris 1136.

It is conceded (Br. 18) that it is quite proper to treat the value of real estate and specific bequests at date of death as the appropriate basis for determining gain derived upon a sale, but it is contended

that the application of the same basis to a residuary legatee is altogether repugnant to any concept of income because a residuary legatee has no right to or any interest in any specific item of property during the period of administration. But this contention overlooks the rule that the title at distribution relates back to the inception of the right, namely, the date of the testator's death. *Foster* v. *Fifield,* 20 Pick. (Mass.) 67, 70; *Thompson* v. *Thomas,* 30 Miss. 152, 158. In *Thompson* v. *Thomas, supra,* the court said:

> Distribution gives to the distributee no new title to the property, but only ascertains the property to which his title shall attach * * *.

In *People ex rel. Crook* v. *Wells,* 179 N. Y. 257, the testator gave his residuary estate, consisting of personal property, to a charitable corporation the property of which was exempt from taxation. The single issue in the case was whether the residuary estate, being still in the hands of the executor, was exempt from taxation. The court said (p. 259):

> That the corporation, at the time of the assessment, was the absolute owner of the $85,000 in personal property assessed is, I think, too clear for controversy. The residuary estate vested in the corporation at the moment of the death of the testator and at no time since his death was the property bequeathed to the charitable corporation subject to taxation.

Since the title of even a residuary legatee relates back to the death of the testator, we submit that the Treasury regulations properly and appropriately made a rule of general application to all bequests. As said by the court below (R. 27):

> To ignore the gain upon so much of the sold title as was equitable would be a subordination of that which is real and substantial to that which is neither.

It is the general policy of the law to follow income into the hands of the recipient and tax it there, and there can be no doubt since *Taft* v. *Bowers, supra,* that the taxation to the recipient of the realized increase from property, even though a portion of the increase occurred before his ownership attached, is not only within the competency of Congress, but that it is neither unreasonable nor arbitrary. The regulations have not attempted to do here all that the Act of Congress involved in the *Taft case* accomplished. The statute involved there was Section 202 (a) (2) of the Revenue Act of 1921, in which Congress provided that the basis for determining gain or loss on the sale of property acquired by gift should be the cost to the donor. In the instant case the regulations have reached only the increase accruing since the death of the testator and have not reached back to the date of original purchase. Congress evinced a purpose in the provisions for taxation of the income of estates to create out of the estate a new taxable entity and

these regulations have gone no further than to hold the beneficiary accountable for the same increase which the personal representative would have had to account for if he had sold the property during the administration of the estate.

Nor does the fact that Section 213 (b) (3) of the 1918 Act excludes from gross income the value of property acquired by gift, bequest, devise or descent, affect the conclusion that the proper basis for determining gain or loss is the value at the date of death. This section of the statute grants an exemption from tax which should be strictly construed to mean that the date of acquisition was the date of death. This exemption renders tax free any and all appreciation in the value of the property which occurs before acquisition. At the same time Congress specifically required the estate to account for all realized increases over the value of the property at the time of the death. (Section 219, Revenue Act of 1918; Regulation 45, Article 343.) These sections are in *pari materia* and we submit that it would not be reasonable to impute to Congress an intention that the increase occurring in the value of property during the period of administration should be exempt from taxation if it were realized by sale by the beneficiary after distribution, although it would be taxed if realized by a sale made by the executors. Section 219 (d) provides with respect to income of the estate which is to be distributed to the beneficiaries periodically, that the bene-

ficiaries, rather than the estate, shall account for the income, whether actually distributed or not, clearly showing that the exemption to the beneficiaries does not include realized increases in value during administration. In fact it is no broader than the sacrifice of the increase in the value of property which was unrealized at death. The creation of a new taxable entity out of the decedent's estate had this effect and we think it is clear that Congress intended to tax to some one all increases occurring thereafter.

Petitioner contends (Br., p. 18) that Section 213 (b) (3) is not in fact an exemption because, irrespective of the statute, the value of the bequests and devises is not income and has never been so considered. This must be deemed an open question. The exemption in Section 4 of the Revenue Act of 1916, c. 463, 39 Stat. 756, 758, referred to bequests and devises as "income." See *Rice* v. *Eisner* (C. C. A. 2d), 16 F. (2d) 358, 360. The language is:

> SEC. 4. The following income shall be exempt from the provisions of this title:
> * * * the value of property acquired by gift, bequest, devise, or descent * * *.

The amendment of this section by Section 1200 of the Revenue Act of 1917, c. 63, 40 Stat. 300, 329, made no change in this language. The Acts of 1918 and 1921 are phrased as providing an exemption. It is an elementary rule that tax exemptions are to be strictly construed. (*Bank of Commerce* v. *Tennessee*, 161 U. S. 134.)

But whether or not the entire bequest could be considered "income" and the language of the Act thus deemed to create a true "exemption," there would seem to be no doubt, under the *Taft case,* of the power of Congress to tax as income, when realized, the entire increase in the value of the bequest from the time of its acquisition by the decedent. The language of the Act is therefore at least a relinquishment of the right to tax part of what could constitutionally have been taxed, that is, the realized appreciation in value of the property from the date of its acquisition by the deceased until the date of his death.

In the absence of some clear indication of Congressional intent to the contrary, that construction should be avoided here which would have the practical effect of extending this relinquishment by rendering free from tax such further appreciation in value as may take place after the death of decedent, when realization is made thereon by sale or other disposition of the property. That the construction urged by the petitioner would have this effect in many cases can not be questioned.

If the construction of the Act advocated by the petitioner had been adopted by the Treasury Department, it would have opened the door to tax avoidance. By reason of the fact that the personal representatives and the beneficiaries are frequently the same persons, or have close family connections, the temptation and opportunity would have been

presented to avoid or minimize tax liability. Such could easily have been accomplished by postponement of distribution during a period of enhancement of values.

We therefore submit that the Treasury regulations under the Revenue Act of 1918, which alone govern the sales of stock made by petitioner in 1920, find support in reason and authority, are calculated to carry out the Congressional purpose, are in entire harmony with the statute, and hence have the force and effect of law.

II

THE REVENUE ACT OF 1921 ENACTED INTO LAW THE PRACTICE OF THE TREASURY UNDER THE PRIOR ACTS SO THAT THE VALUE OF BEQUEATHED PROPERTY AT THE TIME OF THE TESTATOR'S DEATH IS ALSO THE CORRECT BASIS FOR DETERMINING GAIN OR LOSS UNDER THIS ACT

The sales made by petitioner in 1921 and 1922 are controlled by the Revenue Act of 1921. Whereas the only basis specifically mentioned in the prior Acts for determining gain or loss upon the sale of property acquired subsequent to March 1, 1913, was cost, the Revenue Act of 1921 introduced a new provision for determining the gain derived or the loss sustained from the sale of property acquired by bequest. In Section 202 (a) (3) the statute provided:

> In the case of such property, acquired by bequest, devise, or inheritance, the basis shall be the fair market price or value of such property at the time of such acquisition * * *.

Accordingly, with respect to the sales made by petitioner in 1921 and 1922, the more specific question is whether the property was "acquired," within the meaning of this statute, on May 20, 1918, the date of the testator's death, or on April 19, 1920, the date of the order of final distribution.

Congress is presumed to have legislated with knowledge of the existing administrative rule. *United States* v. *Bailey,* 9 Pet. 238, 256. In view of the practice of the Treasury Department under the prior Acts we think the rule that the basis was the value of the property at the time of the testator's death was enacted into law with the passage of the Revenue Act of 1921. At that time it seems to have been accepted that the date of the testator's death was the date of acquisition and that the exemption to which beneficiaries were entitled was limited to the value at that time. The earliest case dealing with this subject was decided by the Board of Tax Appeals on October 20, 1925. *Appeal of Matthiessen, Jr.,* 2 B. T. A. 921. Accordingly, it appears that the departmental construction was unchallenged at the time of the passage of the 1921 Act. Certainly no apt language was used to indicate that Congress desired the rule to be different from the established practice under the prior Acts. On the contrary, Congress, by employing the phrase "time of such acquisition," carried into this section the same meaning which the word "acquired" had come to have in connection with Section 213 (b) (3) of the 1918 Act.

By reason of considerations drawn from the substantive law it has been shown that for practical purposes property acquired by bequest, devise, or descent vests in the beneficiary immediately upon the death of the decedent and that the value of the property at that time was adopted by the Treasury under the prior Acts as the basis for measuring gain or loss upon sale. This being true, we think that the language "time of such acquisition" was used in the 1921 Act as having reference to the same time, that is, the date of the testator's death. We think that Congress recognized the logic and fairness of the earlier regulations and wrote them into the law.

This conclusion is fortified by the fact that courts have also, in discussing personal property passing by reason of a death, spoken of such property as "acquired" at the death of the testate or intestate. Such use of the word appears in the case of *United States* v. *Bolster* (C. C. A., 1st), 26 F. (2d) 760. There the testator provided in his will that the residue of his estate should be held in trust and the income paid to his widow during her lifetime, such provision being made in lieu of her dower and all other claims upon the estate. The provision was accepted by the widow and the question concerned the Government's right to tax the income which she received from the trustee. It was stated by the court (p. 762) that the widow—

> had no interest in the corpus of the estate until the death of her husband * * *.

> At that date she was entitled to receive her statutory share in the corpus of the estate, and "acquired" her property rights in it.

In the same paragraph the court speaks of the fair market value of the property at the time of its "acquisition" and the context of the opinion clearly indicates that the word "acquisition" is intended to relate to the death of the testator.

In *Vail* v. *Vail*, 49 Conn. 52, the testator, who died in 1866, bequeathed a fund to trustees to pay to his children, among whom was a married daughter, the rents, dividends, and income annually. The question was whether payments made to the daughter after the enactment of the Married Women's Act of 1878, which provided that "all property hereafter acquired by any married woman shall be held by her to her sole and separate use," were her separate property. The court said (p. 56):

> It is insisted that the property in question consists only of certain dividends and income which are not *acquired* till actually paid, or at least until they have become payable. (Italics in original.)
>
> * * * * *
>
> But the property bequeathed to Mrs. Vail * * * was "*acquired*" once for all when the will became operative by the decease of the testator. (Italics ours.)

Also in *Matter of Lansing*, 182 N. Y. 238, where a question as to the imposition of an inheritance tax enacted subsequent to the death of the testator was

considered in connection with a remainder following a life estate, the court said (p. 248):

> [The remainder] was *acquired* by Mrs. McVickar under her grandfather's will at the instant of his death. (Italics ours.)

Petitioner cites in his brief (p. 13) two cases in which the court had made use of the word "acquired" seemingly opposed to its employment in the authorities immediately preceding. In the case of *White and Wife* v. *Waite*, 47 Vt. 502, it should be noted that the statute therein considered provided that—

> all personal property and rights of personal action *acquired* by any married woman during coverture, by inheritance *or distribution*, shall be held to her sole and separate use. (Italics ours.) Laws of Vermont, 1867, No. 21.)

In view of the enabling nature of the legislation, the court's liberal construction may perhaps have been justified. As to the case of *Alexander* v. *Alexander*, 85 Va. 353, cited by the petitioner, it appears (p. 367) that the court was also inclined to a liberal construction for the same reason. If, as the petitioner states, the decision applied to the inheritance of real property, this emphasizes the fact that it was the nature of the particular legislation that was determinative, for such interest has long been regarded in the law as "acquired" on the death of the decedent. 2 Bl. Comm. (Lewis Ed.) 201.

In *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, this Court held that premiums paid to the taxpayer's agent must be accounted for by the taxpayer as gross income "received within the year from all sources" despite the contention that the money could not be attached as the taxpayer's property and that while in the possession of the agent the money was not subject to beneficial use by the taxpayer. If property can be "received" for purposes of taxation, even though all the elements of ownership are not present, it would seem to follow that property may also be "acquired" within the meaning of the Revenue Acts notwithstanding the fact that the taxpayer has not come into actual possession.

But any obscurity which might otherwise envelop the meaning of the word acquisition should, we submit, be regarded as dispelled by the contemporaneous construction placed upon the statute by the Treasury regulations and by the subsequent legislative history of the provision. In one of the very first cases on the weight to be given departmental construction, *Edwards* v. *Darby,* 12 Wheat. 207, 210, this Court said that in the construction of a doubtful and ambiguous law the contemporaneous construction of those who were called upon to act under the law and carry its provisions into effect was entitled to very great respect. After the lapse of sixty years the court in *United States* v. *Union Pac. Ry. Co.,* 37 Fed. 551, affirmed, 148 U. S.

562, tracing the growth of this principle in our law, observed that (37 Fed., p. 556)—

> "From the time Justice Trimble announced it so cautiously in 1827 [in *Edwards* v. *Darby, supra*] it has gained strength every time it was again considered by the court. Impelled by the force of its inherent justice, every judge who has taken it up has stated it more strongly than it was stated before."

To the same effect are *United States* v. *Boston & M. R. Co.*, 279 U. S. 732; *United States* v. *Johnston*, 124 U. S. 236, 253; *Brown* v. *United States*, 113 U. S. 568; *Burditt & Williams Co.* v. *United States* (C. C. A. 1st), 153 Fed. 67, 72.

The great force of the rule was said in *United States* v. *Moore*, 95 U. S. 760, 763, to lie in the fact that—

> The officers concerned are usually able men, and masters of the subject. Not unfrequently they are the draftsmen of the laws they are afterwards called upon to interpret.

A fortiori is this true of an internal revenue law such as is here under consideration.

In this particular instance even greater strength is lent to the rule just discussed by reason of the subsequent reenactment in later Acts of the same provision of law after its meaning had been fixed by departmental construction.

Regulations 62, Article 1563, promulgated under the Revenue Act of 1921, construed Section 202 (a) (3) as continuing the Treasury rule which ex-

isted under the prior Acts. In Section 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253, and Section 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9, Congress made no material change in the basis for measuring gain or loss upon the sale of property which was the subject of a bequest. The Treasury regulations under those Acts likewise put a consistent construction upon them. Regulations 65, Article 1594; Regulations 69, Article 1594.

The rule has been settled by numerous decisions of this Court that when Congress reenacts a statute which has received departmental construction it is considered to have given implied legislative recognition and approval to such interpretation, as it is presumed to have legislated with a knowledge of the usage of the executive department of the Government. In other words, departmental interpretation in such case becomes a legislative interpretation and has the force and effect of law. *United States* v. *G. Falk & Brother,* 204 U. S. 143; *United States* v. *Hermanos y Compania,* 209 U. S. 337; *National Lead Co.* v. *United States,* 252 U. S. 140.

Congress twice reenacted the provision in question after the interpretation herein contended for had been given it by the Treasury Department. It is true that before the second of these reenactments, in the Act of 1926, the Board of Tax Appeals had in 1925 laid down a contrary rule in the

Matthiessen case, supra. That and the following similar decisions of the Board were not acquiesced in by the Commissioner of Internal Revenue, and it is submitted that, so far as concerns the construction of the Act of 1921 here involved, which was passed some years before they were decided, they do not affect the rule as to the incorporation of departmental construction into a reenactment of the statute construed.

Nor does it militate against the force and effect of this rule that the Revenue Act of 1928, c. 852, 45 Stat. 791, introduced a change with respect to the basis for measuring gain or loss in the case of property acquired by bequest or devise. In Section 113 (a) (5) thereof (p. 819), it, in short, prescribes that, in the case of personal property acquired by specific bequest, and in the case of realty devised or passing by intestacy, and in the case of any property owned by the decedent and thereafter sold by the personal representative, the basis of ascertaining gain or loss should be the fair market value of the property at the time of the decedent's death. In all other cases of property acquired either by will or by intestacy, the basis should be the fair market value at the time of distribution to the taxpayer.

This new legislation was designed, primarily, to meet the confusion brought about by the decision of the Court of Claims in the case of *May McKinney* v. *United States,* 62 C. Cls. 180, where it was

held that there was no taxable gain where the executors sold, for more than its value at the time of the decedent's death certain corporate stock, which the decedent had purchased, it being shown that the cost price, and the market value of the stock on March 1, 1913, exceeded the amount for which the executors made the sale. The soundness of this decision was questioned both within and without the Department, and for decisions to the contrary see *Appeal of Straight, Executrix,* 7 B. T. A. 177; *Miller, Executrix,* v. *Commissioner,* 11 B. T. A. 854; *Bankers' Trust Co.* v. *Bowers,* 23 F. (2d) 941; *Eldredge* v. *United States,* 31 F. (2d) 924, 930.

Congress was not satisfied to leave the matter in doubt and the committee reports which are set forth in the appendix show that the *McKinney decision* was the occasion for the new legislation. Adopting the proposal of the Finance Committee, Congress, in the Revenue Act of 1928, wrote into the new statute a provision fixing the date of death of the decedent as the basic date where property of the estate was sold by the personal representative. This had always been the interpretation of the Department prior to the decision in the *McKinney case.*

Going further, Congress then proceeded to change the rule theretofore recognized, to the extent of making the basic date the date of distribution where the property did not pass by a specific bequest thereof or was not realty.

Hence it appears that the change in the 1928 Act was not designed to correct any misinterpretation which the Treasury had placed upon the earlier Acts. On the contrary, it was designed to correct another situation and the change with respect to the matter involved in the instant case was incidental to the major purpose of Congress. The fact that the language of an Act has been amended by a subsequent Act indicates an intention to adopt a new rule for the future. *Irwin* v. *Gavit* (C. C. A., 2d), 295 Fed. 84, 88. Under these circumstances there is no room for the contention here that the 1928 Act was a legislative direction to the courts in expounding the provisions of the prior Acts. In the 1928 Act Congress showed a clear change of purpose which should not be given retroactive effect, in view of the strong presumption against retroactivity. *Russell* v. *United States,* 278 U. S. 181. The Board of Tax Appeals has specifically held that the section is not retroactive. *Nellie B. McGee* v. *Commissioner,* 13 B. T. A. 1181, 1184.

Overturning long-continued administrative construction of the Revenue Acts is especially to be deplored. It results in administrative confusion and in discrimination between taxpayers whose cases have been finally closed and those whose cases are still open.

Neither is there any room here for the application of the principle that taxing statutes must be construed most strongly in favor of the taxpayer.

No rule for measure of gain or loss could be framed which would not prove disadvantageous to one class of taxpayers and at the same time advantageous to another class. While it would be to the advantage of petitioner in the instant case to have the date of distribution adopted as the basic date, that basis would work to the disadvantage of many others, depending upon whether the market rose or fell during the period of administration. Therefore, it is evident that the taxpayers are not all on one side of this question and the general principle can have no application here.

The petitioner's argument in this case is in substance a restatement of the *ratio decidendi* in the case of *Appeal of Matthiessen, Jr.*, 2 B. T. A. 921, which, as previously stated (p. 26), was the first case wherein any taxpayer ever sought to litigate the matter of the Department's construction. The Board of Tax Appeals in that case held that the taxpayer, who was the residuary legatee of his father's estate, acquired certain stock at the date of an agreed distribution rather than at the time of decedent's death, and rested its decision primarily upon the premise that the right of the executor or administrator to possession during the period of administration left the legatee with no property right as to any specific assets of the estate. The answer to the petitioner's contention is that the statute is concerned with property which has been received by the legatee and as to such his title relates back to the death of the testator and has never

been divested. See *Christie* v. *C., R. I. & P. Ry. Co.,* 104 Iowa 707. He has remained the real owner throughout all the period during which the property has increased in value.

Petitioner quotes (Br. p. 10) from the case of *United States* v. *Jones,* 236 U. S. 106, which authority was also greatly relied upon by the Board in the *Matthiessen case.* The quotation used by petitioner, however, must be considered in connection with the question involved. This Court was there concerned with a statute prescribing that no succession tax should be assessed or imposed—

> in respect of any contingent beneficial interest which shall not become *absolutely vested in possession or enjoyment* prior to said July first, nineteen hundred and two. (Italics ours.)

Since, in virtue of the statute, no account was to be taken of the vesting in interest, but only of the vesting in enjoyment, it is manifest that the extract from the opinion is of no force here.

In *F. W. Matthiessen* v. *United States,* 65 C. Cls. 484, the decision of the Board of Tax Appeals in the case of the same name was followed and approved. The reasoning of the Court of Claims and the Board of Tax Appeals is not convincing. It proceeds on the theory that Revenue Acts are to be applied in strict accord with the rules relating to the devolution of title and fails to give effect to the apparent adoption by Congress in the 1921 Act of the established meaning given to the word "acquired"

by the practice of the Treasury under the earlier Acts.

In *Alice Fisher Foster* v. *Commissioner*, 7 B. T. A. 1137, *Charles E. Moser* v. *Commissioner*, 12 B. T. A. 672, and *Nellie B. McGee* v. *Commissioner*, 13 B. T. A. 1181, the Board followed its prior decision in the *Matthiessen case*. The *McGee case* involved a California statute under which title to personal as well as real property vested in the heir or the beneficiaries under the will, subject to the lien of the executor and administrator for the payments of debts and to his right of possession. Notwithstanding this, the Board adhered to its earlier decision, showing the extreme importance it attaches to an absolute vesting in possession and its disregard of the practical effect of the interest acquired at the testator's death.

In *Appeal of City Bank Co.*, 1 B. T. A. 210, the Board of Tax Appeals held that a taxpayer who was the successful bidder upon property at a master's sale on February 28, 1913, did not acquire the property prior to March 1, 1913, because the sale was confirmed thereafter on March 24, 1913, and it was only on the latter date that he had obtained it as his own. That case turned on its own facts and there is no necessary analogy between the interest acquired by a successful bidder at a judicial sale and the interest acquired by a beneficiary under a will.

Petitioner refers (Br., pp. 34–35) to a supposed dilemma arising when the executor sells property

received from the decedent but buys other property which eventually is distributed to residuary legatees. The rule of the Treasury Department with respect to the basis for determining gain or loss upon sale of such property by the residuary legatees is that it is the cost of the securities to the executor. (See I. T. 1165, C. B. I–1, 30.) It is submitted that petitioner's criticism of this ruling as involving an abandonment of the position here taken as to the time of acquisition is not well founded but that rather the ruling is entirely consistent with the purpose of the statute as a whole to tax all gains and make allowances for all losses. Section 219 specifically requires the executor to pay a tax on any gain resulting from sales made by him. There is no indication that the statute intended to require both the executor and the legatee to pay a tax upon the same gain. The effect of the departmental practice is to treat the residuary legatee's equitable title to securities in which the executor reinvests as acquired at the time of the reinvestment, so that the basis for determining gain or loss upon a subsequent sale thereof by the residuary legatee is the cost to the executor. Under this construction all realized gains from the death of the decedent are taxed either to the executor or to the legatee, but there is no double taxation.

As to petitioner's illustration (Br., p. 35) of possible inequalities resulting from the department's rule, it may be said that such inequalities may result in unusual cases from the application

of any general rule. Such occasional hardships are beyond judicial cognizance. *Brushaber* v. *Union Pacific R. R.*, 240 U. S. 1. The inequalities suggested may in the usual case be avoided by a distribution by the executor of each class of securities equally among the residuary legatees.

At any rate, this Court is now dealing only with the case in hand, and difficulties that might arise in imagined circumstances do not require present consideration. *Old Colony Trust Co.* v. *Comm'r of Internal Revenue*, 279 U. S. 716; *United States* v. *Sullivan*, 274 U. S. 259, 264; *Yazoo & Mississippi Valley R. R. Co.* v. *Jackson Vinegar Co.*, 226 U. S. 217, 219.

CONCLUSION

In view of the foregoing it is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

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APPENDIX

The Committee on Ways and Means, in House Report No. 2, 70th Congress, First Session, page 18, deals with Section 113 (a) (5) of the Revenue Bill of 1928, as follows:

> In view of the decision of the Court of Claims in *McKinney* v. *United States*, it is desirable specifically to provide what basis shall be used in determining gain or loss on the sale of property by an estate. It is believed that the basis should be the value of the property on the date of the decedent's death, and this rule is incorporated in section 113 (a) (5).
>
> It is also provided, in the same paragraph, that the basis in case of a sale by a beneficiary shall be the value of the property on the date of the decedent's death.
>
> Under existing law, the basis in such a case is the value at the date of "acquisition," which is indefinite and has given rise to controversy. The value on the date of death affords an equitable and more readily determinable basis.

The Senate Committee on Finance stated with respect to the proposed change (Senate Report No. 960, 70th Cong., 1st Sess., p. 26):

> The decision by the Court of Claims in *McKinney* v. *United States* has caused confusion in the existing law as to the basis on which an executor must determine gain or

loss on the sale by him of property of the estate. The House bill in section 113 (a) (5) provides that in such cases the basis shall be the fair market value of the property at the time of the death of the decedent. In the same section the House bill provides the same basis shall be used where the property is sold by the beneficiary.

It appears that the House bill is inadequate to take care of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death can not properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living.

Accordingly, the committee has revised section 113 (a) (5) and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. In these cases it may be said, as a matter of substance, that the property for all practical purposes vests in the beneficiary immediately upon the decedent's death, and therefore the value at the date of death is a proper basis for the determination of gain or loss to the beneficiary. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other

cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary.

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